

3.D. LIQUOR CONTROL BOARD WITH OPERATIONAL IMPROVEMENTS OPTION

This section contains a more detailed review of the Liquor Control Board (LCB) with operational improvements option. An overview of the 2000 Liquor Control Board Retail Services Division can be found in Section 2.B of this report. Findings and recommendations can be found in Sections 3.A – 3.C of this report.

Improvements to the Liquor Control Board's Liquor Sales Operations

The mission of the Liquor Control Board is to serve the public by preventing misuse of alcohol and tobacco through education, enforcement, and controlled distribution. The retail operation should be designed to minimize the inappropriate use of alcohol while at the same time serve those people who use it appropriately. The LCB is at a decision point as it faces the requirements to modernize its retail operations. The information systems, processes and procedures that support the retail sales operations have been in place for many years and are in need of improvement. The Board has proposed major investments in information systems as well as major "process" changes.

Customer surveys conducted by the Liquor Control Board (1999 WSU study) and the United Food and Commercial Workers Local 1001 (1999 Garner Group Poll) both gave high marks to the customer service provided by Washington State retail liquor stores.

The Task Force, through its retail working group, review of the Deloitte & Touche (DT) business plan analysis and discussions with the Liquor Control Board (LCB), believe that improvements can be made in the following areas:

Customer Convenience

- Define store placement and development policies (LCB, DT)
- Add retail outlets to keep pace with growing population (Task Force, LCB)
- Consider expanded use of Agency contracts (Task Force)

Wholesale Operations

- Improve distribution services to wholesale customers (LCB**, Task Force)
- Consider consolidating order fulfillment of wholesale orders through select locations (LCB, DT)
- Centralize special order process through a website or customer service help desk (DT)

Store Practices and Procedures

- Improve merchandising (Task Force, LCB)
 - ✓ Improved displays – in concepts, consistency and implementation
 - ✓ Make more information resources available to stores and customers including product reviews, vintage charts, etc.
 - ✓ Increased use of technology, e.g. Internet
 - ✓ Improved procedures for meeting standards

- Develop and communicate criteria for retail shelf space allocation (Task Force, LCB)
- Institute customer service and product training in stores (DT, LCB, Task Force)
- Continue regular surveys of direct retail customers (DT, LCB, Task Force)

Agency Practices and Procedures

- Make training available to Agency owners and employees (Task Force, LCB)
- Improve the compensation formulas to make it equitable to both large and small stores (Task Force, LCB**)
- Provide for Agencies to participate in technology improvements (Task Force)

Performance Standards and Accountability

- Develop performance standards and accountability for retail operations including: (Task Force, LCB)
 - Quality
 - Cleanliness
 - Stock level
 - Signage and pricing
 - Tracking out-of-stock items
 - Customer service

Wine Sales

- Establish fair practices for the state/private sale of wine (Task Force)

Funding

- Develop effective funding mechanism for the LCB to reinvest profits into improvements in the retail system (Task Force)

Information Technology

- Update information technology Infrastructure (DT, LCB)
- Create a strong Internet capability to further improve processes (DT)
- Consider the purchase of a Point Of Service (POS) system that is centered on a Personal Computer (PC) and easily integrated to planned Merchandising Business System (MBS) and Warehouse Management System (WMS) (LCB, DT)

NOTE:

**** 2001/2003 Biennium Budget Proposals to the Office of Financial Management**

- Installation of a Merchandising Business System with Data Marts to replace obsolete forecasting, purchasing, financing and Point-of-Sale systems (\$4.5M in FY 2002, \$300K in FY 2003 and carried forward into future years.
- Establish a Regional Wholesale Center. (221K in FY 2002 and \$201K in FY 2003 and beyond)
- Increase of 6% in commission for Contract Agencies (\$468K in FY 2002 and 2003)

- Six additional liquor enforcement agents, training and equipment as recommended by the Governor's Citizen's Review Panel. This includes five Enforcement Officers and one MIW (Manufacturers, Importers, and Wholesalers) agent. (\$544K in FY 2002 and \$420K in FY2003)

Considerations For the Evaluation of LCB Option

1) Is effective in controlling liquor abuse/misuse at point of sale

State outlets do control access and therefore availability. While there are no restrictions on the number of outlets, no new outlets have been added in 15 years — just relocations of existing outlets. Outlets have decreased from 180 ten years ago to 157. Although the practice has been to slowly add stores, there is no model in place to site new outlets. LCB recognizes that they need to be more responsive to defining expansion criteria. The only stated limit relates to agency stores. If a state store is in the area, an agency store cannot be sited there. There needs to be a store-siting policy, criteria and procedure.

Consumption of spirits has been declining on a per capita basis. Total consumption has declined. Some of this is culture based. In an OFM study, spirits consumption declined from 3 gallons per capita in 1971 to 1.7 gallons per capita in 1999. What is role of beer in the statistics? We know that it is the adult beverage of choice for youth.

Note: There are a number of consumption statistics. Some are based on quantity of the product (e.g. liter of spirits) and some based on quantity of alcohol (e.g. gallons of ethanol). Some are per capita 21 and over while the National Institute of Health uses per capita 14 years and over. They show the same general trends but are not directly comparable.

Hours are restricted. State stores are not open early in the morning or late at night, hours that could support the abuser or misuser. Seattle store #101, south of downtown, is open to 10 PM.

According to the National Institute for Occupational Safety and Health, between 1980 and 1989, liquor stores rank #2 in the country for workplaces with the highest rates of homicide. None of these deaths occurred in control states with state stores or agencies.

Youth Access: No one under age has any reason to be in the state liquor store. This provides an unmatched model for denial of youth access to spirits. There is very little occurrence of selling to minors in state stores.

Beer is the “adult beverage” of choice of which state stores sell little. Private retail outlets, i.e. drug stores, grocery stores, convenience stores have a broad range of products as well as beer. It is not unusual to have people of all ages in those stores. Kids do not stand out as they do in state stores.

Advertising is prohibited. There is no incentive to sell in retail state stores. They are not revenue driven. Performance goals do not include sales criteria. Private business is profit-driven, or they had better be. The great dilemma for them is to sell or not to sell, when to not sell reduces profits. Obviously, there are other motives that drive private industry and that is not to say there is not support for laws and public health and safety. A business is motivated to comply to retain their license. A private business may well comply with the laws, but it is a dilemma that does not exist in the LCB model.

Controlled access has been linked to lower consumption. NABCA studies show that the adult per capita consumption averaged 22% less in control states. Again, these control states have different models and the Washington model is not the only one that produces lower consumption rates. What we do know is that it supports lower consumption.

2) Is effective and efficient in enforcement of liquor laws

In August 1999, Governor Locke appointed a Citizen Review Panel to examine current practices and policies of the Washington State Liquor Control Board's Enforcement and Education Division, including any overlap with the agency's Licensing and Regulation Division, and to provide recommendations for improvements in systems in order to enhance public trust.

The Panel's findings and recommendations covered seven areas and are currently in various phases of implementation.:

1. Clarification of roles and responsibilities
2. Internal consistency and clarity on rules and procedures
3. Consistency and clarity in regulation of licensees
4. Staffing and training
5. Administrative Violation Notices
6. Complaints against enforcement officers
7. Clear, comprehensive, regularly reported management information

The Enforcement and Education Division recently reorganized to more effectively deal with compliance, prevention and education regarding the serving, use and abuse of alcohol.

3) Maintains or improves revenue generated for the state, cities and counties

According to an analysis done by DISCUS (the Distilled Spirits Council of the United States) in 1998, Washington state ranks #1 in the country for the amount of revenues returned directly to its state from the sale of spirits.

In fiscal year 1999, LCB generated about \$447M in gross liquor sales. \$101.7M was distributed to the state general fund, \$39M to cities and counties, and \$53M to public health and safety programs. (\$193.7M)

According to NABCA, the control states generate nearly twice as much revenue for their states as do licensed states. Expressed as revenue per gallon sold, the control states in 1997 averaged \$19.08 compared to \$10.02 in license states, or about 90% more revenue.

The LCB is a unique agency in that it is self-supporting. It generates enough revenue to pay its entire operating expenses, not just the retail function but all Board operations. The mark-up alone covers the entire LCB operation including licensing and enforcement. See attachment.

4) Maintains current level of revenue support for education, prevention and treatment on affects of alcohol

The current Liquor Control Board distribution of liquor sale generates revenues to public health and safety programs. See attachment.

5) Provides for good paying jobs and benefits for employees

The Washington LCB model provides a stable workforce, which exceeds the normal retail employee retention rate. The most recent turnover rate in the retail division is 15%. This stability provides LCB with the luxury of having well-trained employees almost always available. It reduces the likelihood of youth access to alcohol. The Task Force inquired as to how good pay and benefits, particularly benefits, have contributed to this stability. There may be a need to do a compensation study to determine its relationship to private compensation.

6) Maximizes product choice/selection at a fair market price (Products)

State retail stores offer a broad range of product choice.

Spirit brands	584	Spirit SKUs (stock keeping units)	866
Wine brands	762	Wine SKUs	855
<u>Malt brands</u>	<u>8</u>	<u>Malt SKUs</u>	<u>9</u>
Total brands	1354	Total SKUs	1730

Note: A brand is a specific product independent of size or packaging. A stock keeping unit (SKU) also differentiates based on size.

In addition to regularly listed items, the LCB's special order catalog offers additional products that were ordered at one time and may be available to licensees and retail customers through inventory at various store locations.

Spirits	1098
Wines	2433
Malt	84
Ciders	8
Total	3623

Agency stores don't always have the information available to transfer or order special orders. LCB policy states that store and agency managers can order up to 24 sku's that they can sell. They can special order any brand at any time in case lots. Suppliers may ship in small bottle number cases (less than 12).

LCB believes that product selection can only be matched in super outlets, located in large metropolitan areas. LCB has access through special orders to anything available in the United States.

LCB product selection is continually updated. Listing committees meet 9 to 10 times per year to review new products. The purchasing division stays tuned in to changing trends in consumer preferences and ensures that the state carries the products to meet consumer demands.

In the warehouse, the Control States Bailment Inventory system allows products to be held at the LCB centralized Distribution Center while still under the ownership of the supplier. This system minimizes inventory-carrying costs, as ownership does not pass to the Board until retail outlets order products. It also gives the LCB the ability to carry a higher inventory to provide a cushion for unanticipated demand. LCB maintains a product availability ratio, measured by order fill rate, of 95%. The state doesn't charge bailment storage or handling fees. Bailment doesn't appear to result in higher costs.

Another benefit to the current control system is uniform pricing and product availability. LCB inventory is available to all stores across the state and the price is the same, whether you are in Ephrata or Seattle. It also offers uniform pricing and product availability to all consumers of the State in both large urban areas as well as the smaller populated rural communities.

When addressing selection, 92% of respondents in the WSU customer survey indicated that there was an adequate selection of distilled spirits in WSLCB retail outlets.

There is no sales tax at the point of purchase (8.9%) on spirits. The combined wholesale/retail markup is 45 - 50 %. RCW states that net annual revenue shall not exceed 35%. Liquor taxes are high in WA compared to other states.

Retail liquor prices in Washington are often compared to those in California. California's tax on spirits is \$3.30 per gallon, assessed to the wholesaler as they sell the product to retailers. By contrast, the Washington State liter tax is \$2.4408/liter, which equals \$9.24 per gallon. In addition, Washington has a liquor sales tax of 20.5%. At a manufacturer's bottle cost of \$5.26 the consumer price in California would be \$9.89. In Washington it would be \$11.45.

7) Encourages efficient retail operations

The following is extracted from the Liquor Control Board presentation to the Task Force on October 16, 2000.

Three years ago the LCB drafted a six-year business plan. Two years ago the Governor and Legislature appropriated funds to the LCB to hire an independent consultant to examine that business plan. The LCB then hired Deloitte & Touche as consultants. They also hired WSU to conduct the first ever, statewide customer survey of citizens that frequent the state's liquor stores. Many of the improvements proposed to the LCB retail system were based on information and recommendations from the LCB business plan (1999), the Deloitte Touche Retail Business Plan (1999), the WSU Customer Survey (1999) and the Governor's Task Force retail working group (2000). Changes have also occurred in the structure and personnel associated with LCB liquor sales.

Customer Survey

The WSU customer survey addressed many areas of the retail operations - where they shopped, how far they traveled, how they located the store, hours of operations, how they were treated, convenience, product choice. LCB got high ratings on a professional staff (95) and the amount of time waiting in line (80). There is room for improvement in friendliness and greetings (70/51), product knowledge (62) and overall satisfaction (66). In the area of product availability, those surveyed gave LCB high marks for finding the product they were looking for, though improvements could be made in product selection in both liquor and wine.

LCB is planning to set target goals to improve customer service including customer service training, establishing requirements for store managers and providing better product information to the consumer.

Merchandising Business System

LCB is making both hardware and software upgrades in the retail network to provide better communications. All agency stores are scheduled to get new PCs by the end of the fiscal year. In-house software is being developed to replace the obsolete Telxon devices that many agencies have.

A Virtual Private Network is under development that will provide more efficient communication of transactional data and provide internet/intranet access. Laser printers are being installed in the state stores along with hand-held scanners to support the Warehouse Management System in the new Distribution Center and upgrading the

debit/credit card software. This work is in preparation for implementation of future technologies.

In the future, LCB has plans to install a Merchandising Business System – a fully integrated business system that encompasses all aspects of the retail business. The estimated cost is \$4.8 million (up and running including training). It would begin with a replacement for the current trouble-plagued Point-of-Sale system. Included in the MBS is a purchasing function, tied to the Warehouse Management System, and tied to the financial aspect of the business. They will share data and the efficiency LCB will gain should be very measurable. Efficient purchase order management, accurate and timely billing on wholesale accounts, electronic reconciliation of vendor invoices, accurate store data with sales and product tracking, category management and better inventory management.

The LCB plans to include agency stores in the third phase of MBS implementation (2004).

All of this will result in a better return on the public's investment. With budget approval in this biennium, the system will be in service by 2002. The fallback is for the LCB to write their own Point of Sale software.

Data Marts

In keeping with the recommendation of Deloitte & Touche, after installing the MBS, LCB proposes to pursue building data marts, specifically in 7 areas:

- Store Profitability
- Product
- Regulatory
- Financial
- Human Resources
- Tax Distribution
- Staffing

Data Marts provide the ability to capture data that can then be used to manage specific functions. The current system collects a lot of data; however, it is almost impossible to extract any meaningful “information” about the business.

Wholesale Service Improvements

Beyond that, LCB would like to improve service to class H and other wholesale customers. Still in the talking stages, this could take the form of mini-regional warehouses in densely populated areas, delivery of product or other service enhancements.

Retail Outlets

The state retail system needs to respond to the growing population and provide convenient outlets and to be customer focused and responsive. To do this the LCB believes that they need more employees. The D & T report said that LCB did not need

additional FTEs in state stores. However, they did not consider security as an issue. LCB currently operates some stores with only one employee a certain number of hours each week. This is not a good situation for store employees, considering the product sold and the cash on-hand. LCB also needs to maintain an effective training program for retail staff to include store management, product knowledge, and customer service.

The employee unions would oppose an alternative of opening an agency store in place of a state store.

Funding

In order to do all this, different funding processes must be pursued. To be responsive in a retail environment, the LCB believes that they need additional appropriation authority, perhaps one that provides the ability to use some of the excess dollars from increased sales - or some non-appropriated status for some operations that would allow revenue to be put back into the business. To be responsive in a retail environment, access to funding is essential.

The adoption of any idea needs to be supported by a good business case where objectives are better met or there is an improved return on investment. The difficult task of the Task Force is to compare the options to the objectives, determine if any one model will provide more value or benefit and if the cost of implementing that option will support the added benefit.

8) Is fair to all participants in retail wine operations

An issue, included in many of the Task Force discussions, was that different rules exist for the state and private business in the sale of wine. These include acquisition costs, relationship of wholesale and retail, pricing, payment on delivery, in-state wineries, bailment inventory, advertising, products allowed and hours of sale. Some Task Force members strongly feel that the state should abide by the same rules and regulations that they impose on the private sector.

These issues have been discussed since the 1969 wine legislation. Prior to that time the state was the sole distributor of out-of-state wines. Over 50% of the wine was sold through state stores in the 1960's. This number is now down to 10%. The state retail stores are important outlets for many of Washington's smaller wineries.

Some ideas discussed by the Task Force under the LCB retail sales and agency option were:

- Allow the individual contract agency manager to decide whether to purchase wine and/or beer through private wholesalers based upon consumer demand and customer service criteria for their area.
 - Contract agencies would be required to apply for a beer and wine license

- Address the parity issue in the state/agency retail sales of wine and beer.
Possible solutions include:
 - Require state and agency stores to buy all wine and beer products through the private wholesale system. This would, in effect, require the state to abide by the same rules as private sector businesses, or
 - Set the retail price of wine and beer provided through the state wholesale system based on the private wholesale acquisition cost and retail markup, or
 - Eliminate wine and beer sales in state and agency stores, or
 - Other options
- Find ways to improve the distribution of wine from Washington wineries

The Task Force reached no clear consensus on recommendations for resolution of these issues. It is clear, however, that there is a need to address fair practices for the state/private sale of wine.

Additional discussion on this issue can be found in Appendix J.ii.

9) Minimizes conflict of interests – profit vs. control

Input from Task Force members and the public has expressed serious concerns regarding the inherent tension between selling alcohol for a profit and controlling the misuse of a regulated product with public health and safety consequences. The LCB believes that there is no conflict as the retail operation is part of the control strategy.

10) Provides for local control and community accountability

While local control is an option in Washington, the process is complex.

Overall Impact of Retail Liquor Sales Option

11) Promotes the greatest good for the greatest number

The majority of the public input received by the Task Force seems to support the current State store system, but various individuals and groups are looking for improvements.

Approximately 75% of the responses actively supported the current system or talked only about changes they would like to see to the current system.

- Some of the changes mentioned are location of both State and Agency stores, number of stores, selection, customer service, modern computer systems and the often-heard request for a level playing field regarding the sale of wine and beer.

Groups generally supporting the current system include:

- Law Enforcement community
- Wine and Wine-related businesses
- Public Safety/Health community
- Food Retailers
- Distributors
- Union Representatives
- LCB Employees and Managers.

More than two thirds of the unaffiliated citizens (30 out of 42) support the current system.

Implementation Feasibility

12) Is feasible to implement effectively

The system is in place. Legislative approval required to implement the improvements in systems and processes.